

### **Housing and Urban Development Requirements**

The Company's mortgage operation is a U.S. Department of Housing and Urban Development approved non-supervised mortgagee and is required to maintain an excess of current assets over current liabilities and minimum net worth, as defined by the various regulatory agencies. Such equity requirement is tied to the size of the Company's servicing portfolio and ranged up to \$1.0 million. The Company is also required to maintain fidelity bonds and errors and omissions insurance coverage based on the balance of its servicing portfolio. The Company is in compliance with these regulatory requirements.

### **Registered Broker-Dealer Requirements**

Doral Securities is registered as a broker-dealer with the Securities and Exchange Commission ("SEC") and the Puerto

Rico Office of the Commissioner of Financial Institutions (the "CFI"). Doral Securities is also a member of the National Association of Securities Dealers (the "NASD"). As a registered broker-dealer, Doral Securities is subject to regulation by the SEC, the NASD and the CFI in matters relating to the conduct of its securities business, including record-keeping and reporting requirements, supervision and licensing of employees and obligations to customers. In particular, Doral Securities is subject to net capital rules, which specify minimum net capital requirements for registered broker-dealers. These are designed to ensure that such institutions maintain adequate regulatory capital in relation to their liabilities and the size of their customer business. As of December 31, 2004, the Company was in compliance with these regulatory capital requirements.

### **4. Money Market Investments**

At December 31, 2004, the Company had \$806.9 million in time deposits and other short-term money market investments pledged as collateral for securities sold under agreement to repurchase, which the counterparty can repledge.

The carrying value of securities purchased under agreements to resell included in money market investments and the estimated collateral market value of the underlying securities, at December 31, 2004, are summarized as follows:

(In thousands)	Type of Collateral Pledged	Collateral		December 31, (In thousands)	
		Carrying Value	Estimated Market Value		
U.S. Government and Agencies		\$ 49,245	\$ 50,250	\$ 1,243,543	\$ 944,150

The dealers who arranged the transactions held these securities on behalf of the Company. At December 31, 2004, the Company has not sold or repledged any of its securities purchased under agreements to resell.

### **5. Securities Held for Trading**

Securities held for trading consisted of:

		December 31,	
		2004	2003
<b>Mortgage-backed securities:</b>			
GNMA exempt		\$ 266,380	\$ 290,202
GNMA taxable		50,974	23,641
CMO certificates		4,299	6,691
FHLMC and FNMA		18,286	26,063
Interest-only strips		878,732	578,124
Puerto Rico Government and Agencies		5,444	5,646
Other		19,428	13,783
		\$ 1,243,543	\$ 944,150

Net unrealized loss on trading securities, excluding derivative instruments, as of December 31, 2004, amounted to approximately \$124.6 million (including losses on the value of the IOs of \$131.0 million). At December 31, 2003, net unrealized gain on trading securities amounted to \$15.8 million (including gains on the value of the IOs of \$7.3 million). The weighted-average yield on securities held for trading, including IOs, as of December 31, 2004 was 6.71% (2003 – 7.21%).

Set forth below is a summary of the components of net gain (loss) from securities held for trading:

(In thousands)		Year ended December 31,		
		2004	2003	2002
Net realized gains on sales of securities held for trading (Losses) and gains on the IO valuation		\$ 24,900	\$ 120,528	\$ 84,404
Net unrealized gains and (losses) on trading securities, excluding IOs		(131,007)	7,314	(6,465)
Net realized and unrealized losses on derivative instruments		3,385	(14,870)	9,057
Total		(97,885)	(107,381)	(91,267)
		\$ (200,607)	\$ 5,591	\$ (4,271)

**6. Securities Available for Sale**

The amortized cost, gross unrealized gains and losses, approximate market value, weighted-average yield and contractual maturities of securities available for sale as of December 31, 2004 and 2003 (2002 – only market value and weighted-average yield are presented), were as follows:

(Dollars in thousands)	2004					Weighted-Average Yield
	Amortized Cost	Unrealized Gains	Unrealized Losses	Market Value		
<b>Mortgage-Backed Securities</b>						
GNMA						
Due over ten years	\$ 2,946,222	\$ 985	\$ 11,297	\$ 2,935,910		5.62%
FHLMC and FNMA						
Due over ten years	398,662	98	9,403	389,357		5.18%
<b>Debt Securities</b>						
FHLB Notes						
Due over ten years	111,951	2,255	–	114,206		5.51%
U.S. Treasury						
Due from one to five years	500,078	–	8,492	491,586		1.66%
Due from five to ten years	863,077	–	27,784	835,293		3.71%
Due over ten years	219,577	–	3,421	216,156		4.71%
	<u>\$ 5,039,567</u>	<u>\$ 3,338</u>	<u>\$ 60,397</u>	<u>\$ 4,982,508</u>		<u>4.83%</u>
2003						
(Dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Market Value	Weighted-Average Yield	Weighted-Average Yield
<b>Mortgage-Backed Securities</b>						
GNMA						
Due over ten years	\$ 467,451	\$ 553	\$ 5,096	\$ 462,908	5.70%	\$ 12,780
FHLMC and FNMA						
Due over ten years	539,034	196	13,360	525,870	5.17%	174,586
<b>Debt Securities</b>						
FHLB Zero Coupon						
Due over ten years	–	–	–	–	–	105,000
FHLB Notes						
Due over ten years	111,940	–	1,847	110,093	5.25%	–
FHLMC Notes						
Due over ten years	–	–	–	–	–	25,315
U.S. Treasury						
Due from one to five years	149,897	291	–	150,188	1.84%	–
Due from five to ten years	1,375,706	–	35,144	1,340,562	3.87%	238,309
Due over ten years	266,962	–	5,985	260,977	4.92%	306,100
	<u>\$ 2,910,990</u>	<u>\$ 1,040</u>	<u>\$ 61,432</u>	<u>\$ 2,850,598</u>	<u>4.45%</u>	<u>\$ 862,090</u>
						5.38%

The weighted-average yield is computed based on amortized cost and, therefore, does not give effect to changes in fair value.

Proceeds from sales of securities available for sale during 2004 were approximately \$10.0 billion (2003 – \$7.0 billion and 2002 – \$5.4 billion). For 2004, gross gains of \$60.2 million (2003 – \$33.9 million and 2002 – \$49.6 million) were realized on those sales. For 2004, gross losses of \$49.6 million (2003 – \$28.5 million and 2002 – \$25.7 million) were realized on those sales.

Expected maturities of mortgage-backed securities and certain debt securities might differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, the Company may designate a derivative as a hedge of the fair value of a recognized

fixed rate asset or liability. From time to time certain hedging activities related to certain available-for-sale securities are accounted for as a fair value hedge. In a qualifying fair value hedge, both the changes in fair value of the hedged item (in this case available-for-sale securities) and changes in fair value of the derivative are included in net gain (loss) on securities held for trading in the Consolidated Statements of Income. As a result, any hedge ineffectiveness is reflected immediately in earnings. During 2004, the Company recognized losses of \$7.0 million that represents the ineffective portion of the fair value hedges of its available-for-sale securities. Derivatives hedging the fair value of certain available-for-sale securities expired during the third quarter of 2004 and the Company decided to discontinue the fair value hedge for such securities. As a result of the fair value hedge discontinuance, the favorable cumulative mark-to-market valuation from the inception date of the fair value hedge to its discontinuance date of approximately \$27.2 million is being amortized as a yield adjustment over the remaining life of the securities.

**7. Securities Held to Maturity**

The amortized cost, gross unrealized gains and losses, approximate market value, weighted-average yield and contractual maturities of securities held to maturity as of December 31, 2004 and 2003 (2002 – only amortized cost and weighted-average yield) were as follows:

(Dollars in thousands)	2004					Weighted-Average Yield
	Amortized Cost	Unrealized Gains	Unrealized Losses	Market Value		
<b>Mortgage-Backed Securities</b>						
GNMA						
Due from one to five years	\$ 493	\$ 25	–	\$ 518		6.50%
Due from five to ten years	618	33	–	651		7.00%
Due over ten years	5,754	336	–	6,090		7.00%
FHLMC and FNMA						
Due over ten years	437,426	1,190	3,607	435,009		5.22%
CMO Certificates						
Due from one to five years	614	–	3	611		6.10%
Due over ten years	25,264	11	440	24,835		6.58%
<b>Debt Securities</b>						
FHLB Notes						
Due from one to five years	100,000	–	941	99,059		2.89%
Due from five to ten years	50,000	250	–	50,250		4.13%
Due over ten years	398,587	1,102	5,040	394,649		5.38%
FHLB Zero Coupon						
Due over ten years	167,361	–	5,942	161,419		6.51%
FHLMC Zero Coupon						
Due over ten years	282,947	–	7,971	274,976		5.90%
FHLMC and FNMA Notes						
Due over ten years	149,988	46	1,285	148,749		5.63%
P.R. Housing Bank						
Due from one to five years	5,000	50	–	5,050		6.00%
Due over ten years	2,235	28	–	2,263		6.20%
U.S. Treasury						
Due from five to ten years	201,484	–	7,765	193,719		3.52%
Due over ten years	473,689	975	34,204	440,460		4.33%
Other						
Due from one to five years	7,950	17	–	7,967		4.32%
Due from five to ten years	370	8	–	378		6.75%
Due over ten years	7,000	40	–	7,040		5.93%
	<u>\$ 2,316,780</u>	<u>\$ 4,111</u>	<u>\$ 67,198</u>	<u>\$ 2,253,693</u>		<u>5.02%</u>

(Dollars in thousands)	2003					2002		
	Amortized Cost	Unrealized Gains	Unrealized Losses	Market Value	Weighted- Average Yield	Amortized Cost	Weighted- Average Yield	
<b>Mortgage-Backed Securities</b>								
GNMA								
Due from five to ten years	\$ 1,682	\$ 89	\$ -	\$ 1,771	6.75%	\$ 2,227	6.74%	
Due over ten years	7,908	482	-	8,390	6.97%	11,253	6.99%	
CMO Certificates								
Due within a year	40	-	-	40	8.25%	-	-	
Due from one to five years	677	-	2	675	6.78%	274	7.62%	
Due from five to ten years	462	-	3	459	5.80%	1,257	6.28%	
Due over ten years	43,182	2	781	42,403	6.23%	67,140	5.99%	
Debt Securities								
FHLB Notes								
Due from one to five years	50,000	-	-	50,000	3.05%	-	-	
Due over ten years	517,960	2,051	-	520,011	5.58%	394,365	5.59%	
FHLB Zero Coupon								
Due over ten years	288,253	-	1,099	287,154	6.63%	314,202	6.82%	
FHLMC Zero Coupon								
Due over ten years	34,287	-	5,500	28,787	6.01%	37,116	7.87%	
FHLMC Notes								
Due over ten years	-	-	-	-	-	50,000	6.00%	
P.R. Housing Bank								
Due from one to five years	5,000	50	-	5,050	6.00%	5,000	6.00%	
Due over ten years	2,235	-	-	2,235	6.20%	3,305	6.20%	
U.S. Treasury								
Due from five to ten years	201,661	-	9,161	192,500	3.51%	-	-	
Due over ten years	476,167	3,503	46,498	433,172	4.38%	61,092	5.36%	
P.R. Economic Development								
Bank Notes								
Due within a year	-	-	-	-	-	2,000	6.60%	
Other								
Due within a year	-	-	-	-	-	5,000	3.51%	
Due from one to five years	3,680	11	4	3,687	5.33%	355	6.48%	
Due from five to ten years	715	13	-	728	6.73%	4,040	5.48%	
Due over ten years	7,000	40	-	7,040	5.93%	2,000	7.00%	
	<u>\$ 1,640,909</u>	<u>\$ 6,241</u>	<u>\$ 63,048</u>	<u>\$ 1,584,102</u>	<u>5.13%</u>	<u>\$ 960,626</u>	<u>6.13%</u>	

The weighted-average yield is computed based on amortized cost and, therefore, does not give effect to changes in fair value. Expected maturities of mortgage-backed securities and certain debt securities might differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

**8. Investments in an Unrealized Loss Position**

The following tables show the Company's gross unrealized losses and fair value for available-for-sale and held-to-maturity investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2004.

**Securities available for sale**

(In thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>Mortgage-Backed Securities</b>						
GNMA	\$ 2,262,950	\$ 8,869	\$ 158,223	\$ 2,421,173	\$ 11,297	
FHLMC and FNMA	35,340	201	345,679	9,202	381,019	9,403
<b>Debt Securities</b>						
U.S. Treasury	1,300,887	24,068	242,148	15,629	1,543,035	39,697
	<u>\$ 3,599,177</u>	<u>\$ 33,138</u>	<u>\$ 746,050</u>	<u>\$ 27,259</u>	<u>\$ 4,345,227</u>	<u>\$ 60,397</u>

**Securities held to maturity**

(In thousands)	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>Mortgage-Backed Securities</b>						
FHLMC and FNMA	\$ 199,860	\$ 3,607	—	—	\$ 199,860	\$ 3,607
CMO Certificates	7,069	167	9,161	276	16,230	443
<b>Debt Securities</b>						
FHLB Notes	367,606	5,981	—	—	367,606	5,981
FHLB Zero Coupon	53,725	658	107,694	5,284	161,419	5,942
FHLMC Zero Coupon	242,758	3,779	32,218	4,192	274,976	7,971
FHLMC and FNMA Notes	98,715	1,285	—	—	98,715	1,285
U.S. Treasury	—	—	571,992	41,969	571,992	41,969
	<u>\$ 969,733</u>	<u>\$ 15,477</u>	<u>\$ 721,065</u>	<u>\$ 51,721</u>	<u>\$ 1,690,798</u>	<u>\$ 67,198</u>

The securities held by the Company are principally mortgage-backed securities, U.S. Treasury and agency securities. Thus, a substantial portion of these instruments is guaranteed by mortgages, a U.S. government-sponsored entity or the full faith and credit of the U.S. government and, therefore, principal and interest on the securities are deemed recoverable. The Company has the ability and intent to hold the securities until maturity or until the unrealized losses are recovered. Therefore, no other-than-temporary impairment loss has been recognized.

**9. Mortgage Loans Held for Sale**

At December 31, mortgage loans held for sale consisted of the following:

(In thousands)	2004	2003
Conventional single family residential loans	\$ 1,207,386	\$ 1,532,149
FHA/VA loans	96,161	87,810
Mortgage loans on residential multifamily	42,759	79,641
Construction and commercial real estate loans	214,643	266,982
Consumer loans secured by mortgages	—	26
	<u>\$ 1,560,949</u>	<u>\$ 1,966,608</u>

At December 31, the aggregate amortized cost and approximate market value of these loans were as follows:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Market Value
2004	\$ 1,560,949	\$ 26,810	\$ 7,702	\$ 1,580,057
2003	<u>\$ 1,966,608</u>	<u>\$ 55,165</u>	<u>\$ 2,178</u>	<u>\$ 2,019,595</u>

#### **10. Loans Receivable**

Loans receivable are related to the Company's banking and construction loan operations and consisted of:

(In thousands)	December 31,	
	2004	2003
Construction loans <sup>(1)</sup>	\$ 629,913	\$ 603,909
Residential mortgage loans	609,148	529,147
Commercial-secured by real estate	368,699	152,016
Consumer-secured by real estate	320	375
Consumer-other:		
Personal loans	28,865	31,083
Auto loans	1,175	1,291
Credit cards	13,401	8,367
Overdrawn checking account	524	357
Revolving lines of credit	26,614	25,418
Lease financing receivables	7,488	—
Commercial non-real estate	36,848	22,006
Loans on savings deposits	9,354	8,769
Land secured	51,853	65,818
Loans receivable, gross	1,784,202	1,448,556
Less:		
Unearned interest and deferred loan fees, net	(10,966)	(17,998)
Allowance for loan losses	(20,746)	(19,709)
	(31,712)	(37,707)
Loans receivable, net	\$ 1,752,490	\$ 1,410,849

(1) Includes \$556.0 million and \$102.2 million of construction loans for residential housing projects as of December 31, 2004 and 2003, respectively. Also includes \$73.9 million and \$201.7 million of construction loans for commercial, condominiums and multifamily projects as of December 31, 2004 and 2003, respectively.

At December 31, 2004, fixed-rate loans and adjustable-rate loans were approximately \$849.8 million and \$934.4 million, respectively.

The adjustable rate loans, mostly composed of construction loans for residential projects, land loans and certain residential mortgage loans, have interest rate adjustment limitations and are generally tied to various market indexes. Future market factors may affect the correlation of the interest rate adjustment with the rate the Company pays on the short-term deposits that have primarily funded these loans.

Impaired loans as of December 31, 2004 and 2003, amounted to approximately \$31.5 million and \$23.7 million, respectively. At December 31, 2004, an impairment allowance of approximately \$7.1 million (2003 – \$2.4 million) was allocated to certain impaired loans with an aggregate principal outstanding balance of \$20.7 million (2003 – \$23.7 million). Average impaired loans for the years ended December 31, 2004 and 2003, were \$28.9 million and \$28.2 million, respectively.

As of December 31, 2004, the Company had loans receivable and mortgage loans held for sale, including impaired

loans over 90 days delinquent, amounting to approximately \$44.8 million (2003 – \$44.3 million) on which the accrual of interest income had been discontinued. If these loans

had been accruing interest, the additional interest income realized would have been approximately \$4.7 million (2003 – \$7.5 million).

## **11. Allowance for Loan Losses**

Changes in the allowance for loan losses were as follows:

(In thousands)	Year ended December 31,		
	2004	2003	2002
Balance at beginning of year	\$ 28,211	\$ 18,243	\$ 12,472
Provision for loan losses	5,507	14,085	7,429
Recoveries	436	244	196
Other adjustments	(199)	150	(32)
Losses charged to the allowance	<u>(5,554)</u>	<u>(4,511)</u>	<u>(1,822)</u>
Balance at the end of year	\$ 28,401	\$ 28,211	\$ 18,243

The Company allocates the allowance for loan losses between loans held for sale and loans receivable. At December 31, 2004, approximately \$7.7 million and \$20.7 million (2003 – \$8.5 million and \$19.7 million, respectively, 2002 – \$8.2 million and \$10.0 million, respectively) of the total allowance for loan losses were allocated to loans held for sale and loans receivable, respectively.

## **12. Servicing Activities**

The components of net servicing income (loss) are shown below:

(In thousands)	Year ended December 31,		
	2004	2003	2002
Servicing fees	\$ 28,697	\$ 25,793	\$ 25,498
Late charges	7,393	6,958	6,522
Prepayment penalties	6,201	5,334	4,115
Interest loss	(2,620)	(2,974)	(2,331)
Other servicing fees	<u>923</u>	<u>216</u>	<u>161</u>
Servicing income, gross	40,594	35,327	33,965
Amortization and impairment of servicing assets	<u>(35,701)</u>	<u>(50,444)</u>	<u>(40,630)</u>
Servicing income (loss), net	\$ 4,893	\$ (15,117)	\$ (6,665)

The changes in servicing assets are shown below:

(In thousands)	Year ended December 31,		
	2004	2003	2002
Balance at beginning of year	\$ 178,890	\$ 169,033	\$ 154,340
Capitalization	71,448	58,061	46,171
Amortization	(28,651)	(34,576)	(31,478)
Application of valuation allowance to write-down permanently impaired servicing assets	<u>(10,540)</u>	<u>(13,628)</u>	<u>–</u>
Balance before valuation allowance at end of year	211,147	178,890	169,033
Valuation allowance for temporary impairment	<u>(7,902)</u>	<u>(11,392)</u>	<u>(9,152)</u>
Balance at end of year	\$ 203,245	\$ 167,498	\$ 159,881

Effective July 1, 2002, impairment charges are recognized through a valuation allowance for each individual stratum of mortgage loans subject to servicing assets. The valuation allowance is adjusted to reflect the amount, if any, by which the cost basis of the servicing asset for a given stratum of loans being serviced exceeds its fair value. Any fair value in excess of the cost basis of the servicing asset for a given stra-

tum is not recognized. Other-than-temporary impairment, if any, is recognized as a direct write-down of the servicing assets, and the valuation allowance is applied to reduce the cost basis of the the servicing asset .Prior to July 1, 2002, Doral Financial recorded all impairment charges as a direct write-down of servicing assets.

Changes in the impairment allowance were as follows:

(In thousands)	Year Ended December 31,		
	2004	2003	2002
Balance at beginning of year	\$ 11,392	\$ 9,152	\$ —
Temporary impairment charges	19,416	24,590	12,364
Write-down for permanent impaired servicing assets	(10,540)	(13,628)	—
Recoveries	(12,366)	(8,722)	(3,212)
Balance at end of year	\$ 7,902	\$ 11,392	\$ 9,152

The Company's servicing portfolio amounted to approximately \$14.3 billion, \$12.7 billion and \$11.2 billion at December 31, 2004, 2003 and 2002, respectively, including \$1.9 billion, \$2.5 billion and \$1.9 billion, respectively, of loans owned by the Company for which no servicing asset has been recognized.

During the years ended December 31, 2004, 2003 and 2002, the Company purchased servicing rights to approximately

\$266.6 million, \$616.0 million and \$381.2 million, respectively, in principal amount of mortgage loans.

Under most of the servicing agreements, the Company is required to advance funds to make scheduled payments to investors, if payments due have not been received from the mortgagors. At December 31, 2004, receivables and mortgage-servicing advances included advances to investors of approximately \$36.3 million (2003 – \$29.5 million).

### **13. Sale of Mortgage Loans**

As disclosed in Note 2, the Company routinely originates, securitizes and sells mortgage loans into the secondary market. As a result of this process, the Company typically retains the servicing rights and may retain interest-only strips. The Company's retained interests are subject to prepayment and interest rate risks.

In 2004, 2003, and 2002, the Company recognized gains of \$598.8 million, \$390.1 million, and \$220.6 million, respectively, on the sales and securitization of residential mortgage loans.

Values used in measuring the retained interests at the date of the sales of the loans resulting from transactions completed during the year were as follows:

- Servicing Assets from Loan Sales – The Company measures the servicing assets at the date of the sales based on current market rates in similar transactions ranging

from 1.40% to 2.30% per annum during 2004 and 2003, depending on the type of loan.

- Interest-Only Strips – The Company measures the interest-only strips at the date of the transaction based on market values computed based on interest rate spreads on loans sold multiplied by a market multiple. These market multiples ranged from 4.95 to 5.50 during 2004 (2003 – 4.75 to 5.50).

At December 31, 2004, fair values of the Company's retained interests were based on prices provided by dealers as well as external and internal discounted cash flow models that incorporate assumptions regarding discount rates, mortgage prepayment rates, and spot LIBOR rates. The key economic assumptions used by the Company in its internal valuation models and the sensitivity of the current fair value of residual cash flows to immediate 10 percent and 20 percent adverse changes in those assumptions for mortgage loans at December 31, 2004, were as follows:

(Dollars in thousands)	Servicing Assets	Interest-Only Strips
Carrying amount of retained interest	\$ 203,245	\$ 878,732
Weighted-average remaining life (in years)	7	8
<b>Constant prepayment rate (annual rate)</b>	<b>9.45%</b>	<b>7.20%</b>
Impact on fair value of 10% adverse change	\$ 5,984	\$ 24,134
Impact on fair value of 20% adverse change	\$ 11,590	\$ 45,785
<b>Residual cash flow discount rate (annual)</b>	<b>9.70%</b>	<b>7.63%</b>
Impact on fair value of 10% adverse change	\$ 7,853	\$ 31,111
Impact on fair value of 20% adverse change	\$ 15,175	\$ 60,354

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 10 percent variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for

example, increases in market interest rates may result in lower prepayments), which may magnify or counteract the sensitivities.

The following table summarizes the estimated change in the fair value of the Company's IOs, net of embedded caps, as of December 31, 2004, given several hypothetical (instantaneous and parallel) increases in the 3-month LIBOR and do not consider hedging strategies used by the Company.

	Change in Fair Value			
	+25	+50	+100	+200
Change in 3-month LIBOR (basis points)	\$ (69.9) million	\$ (138.8) million	\$ (274.7) million	\$ (542.2) million
Change in Fair Value of IOs				

The analysis in the above table is limited in that it was performed at a particular point in time and does not incorporate changes in other factors or assumptions that would impact the sensitivity of the IO valuation in such scenarios.

The activity in interest-only strips is shown below:

(In thousands)	2004	2003	2002
Balance at beginning of year	\$ 578,124	\$ 359,185	\$ 218,848
Capitalization of IOs from loan sales	509,349	281,273	197,919
Amortization	(101,550)	(79,622)	(40,527)
(Losses) gains on the IO value	(131,007)	7,314	(6,465)
Purchases of IOs	23,816	9,974	10,720
Sales of IOs	—	—	(21,310)
Balance at end of year	\$ 878,732	\$ 578,124	\$ 359,185

The following table presents quantitative information about delinquencies, net credit losses, and components of loans sold with recourse:

(In thousands)	Principal Amount of Loans	Principal Amount of Loans	60 days or More Past Due <sup>(1)</sup>	Net Credit Losses <sup>(2)</sup>
<b>Type of Loan</b>				
Residential mortgage and commercial loans sold with recourse agreements	\$ 3,931,039	\$ 164,134	\$ 1,459	

(1) Loans 60 days or more past due are based on end of period total loans.

(2) Net credit losses are charge-offs and are based on total loans outstanding.

Recourse sales generally involve the sale of non-conforming loans to local financial institutions and to FNMA and FHLMC. As of December 31, 2004 and 2003, the Company's contractual recourse obligations relating to its mortgage-servicing portfolio were approximately \$3.3 billion and \$1.9 billion,

respectively. As of December 31, 2004, the Company had an allowance for recourse obligations of \$10.8 million (2003 - \$3.7 million). Historical losses on recourse obligations have not been significant.

#### **14. Premises and Equipment**

Premises and equipment consisted of:

(In thousands)	December 31,	
	2004	2003
Office building	\$ 64,068	\$ 62,006
Office furniture and equipment	65,589	59,066
Leasehold improvements	49,617	38,202
Automobiles	356	301
	179,630	159,575
Less - accumulated depreciation and amortization	(52,523)	(41,667)
Land	127,107	117,908
Construction in progress	16,354	13,562
	3,090	4,567
	\$ 146,551	\$ 136,037

#### **15. Sources of Borrowings**

At December 31, 2004, the scheduled aggregate annual maturities of the Company's sources of borrowings were approximately as follows:

(In thousands)	Advances					
	Deposits	Repurchase Agreements	from the FHLB	Loans Payable	Notes Payable	Total
2005	\$ 2,470,099	\$ 3,912,860	\$ 375,000	\$ 279,560	\$ 130,354	\$ 7,167,873
2006	430,309	-	-	-	82,760	513,069
2007	352,325	270,000	117,000	-	637,325	1,376,650
2008	245,699	464,425	100,000	-	855	810,979
2009	129,607	205,093	25,000	-	915	360,615
2010 and thereafter	15,041	1,452,785	677,500	-	252,993	2,398,319
	\$ 3,643,080	\$ 6,305,163	\$ 1,294,500	\$ 279,560	\$ 1,105,202	\$ 12,627,505

#### **16. Deposit Accounts**

At December 31, deposits and their weighted-average interest rates are summarized as follows:

(Dollars in thousands)	2004		2003	
	Amount	%	Amount	%
Certificates of deposit	\$ 1,983,271	3.21	\$ 1,695,671	2.99
Regular savings	474,271	2.29	443,050	2.27
NOW accounts	726,178	2.12	468,259	2.11
Non interest-bearing deposits	459,360	-	364,292	-
	\$ 3,643,080	2.47	\$ 2,971,272	2.38

At December 31, 2004 and 2003, certificates of deposit over \$100,000 amounted to approximately \$1.7 billion and \$1.4 billion, respectively. Brokered certificates of deposit amounted to \$1.3 billion and \$985.3 million at December 31, 2004 and 2003, respectively. The banking subsidiaries had brokered certificates of deposit maturing as follows:

(In thousands)

As of December 31, 2004

2005	\$ 289,605
2006	360,788
2007	313,900
2008	195,369
2009	116,458
2010 and thereafter	14,271
	<u>\$ 1,290,391</u>

At December 31, 2004, Doral Financial's banking subsidiaries had deposits from officers, directors, employees and principal stockholders of the Company amounting to approximately \$8.7 million (2003 – \$6.3 million).

The Company, as a servicer of loans, is required to maintain certain balances on behalf of the borrowers called escrow funds. At December 31, 2004, escrow funds amounted to approximately \$222.4 million (2003 – \$182.3 million), of which \$171.2 million were deposited with Doral Bank-PR (2003 – \$158.5 million). The remaining escrow funds were deposited with other banks and therefore excluded from the Company's assets and liabilities.

#### **17. Securities Sold Under Agreements to Repurchase**

The following summarizes significant data about securities sold under agreements to repurchase for the years ended December 31, 2004 and 2003.

<i>(Dollars in thousands)</i>	<i>2004</i>	<i>2003</i>
Carrying amount as of December 31,	<u>\$ 6,305,163</u>	<u>\$ 3,602,942</u>
Average monthly aggregate balance outstanding	<u>\$ 4,805,381</u>	<u>\$ 2,999,339</u>
Maximum balance outstanding at any month end	<u>\$ 6,305,163</u>	<u>\$ 3,602,942</u>
Weighted-average interest rate during the year	<u>2.51%</u>	<u>3.02%</u>
Weighted-average interest rate at year end	<u>2.73%</u>	<u>2.46%</u>

Securities sold under agreements to repurchase as of December 31, 2004, grouped by counterparty, were as follows:

<i>(Dollars in thousands)</i>	<i>Repurchase Liability</i>	<i>Weighted-average Maturity (in months)</i>
<b>Counterparty</b>		
Merrill Lynch, Pierce, Fenner & Smith, Inc.	\$ 1,387,653	40.9
Morgan Stanley DW, Inc.	1,199,104	0.9
Countrywide Securities, Corp.	820,880	0.6
Credit Suisse First Boston, LLC	631,693	27.6
Lehman Brothers, Inc.	513,978	66.4
Federal Home Loan Bank of New York	427,900	52.9
Wachovia Capital Markets	390,041	0.6
Citibank, N.A. – Puerto Rico	347,872	108.7
FIMAT, USA, LLC	257,216	0.1
Popular Securities, Inc.	203,786	37.7
Others	125,040	4.9
Total	<u>\$ 6,305,163</u>	<u>28.3</u>

The carrying and market values of securities available for sale and securities held to maturity pledged as collateral at December 31, shown by maturity of the repurchase agreement, were as follows:

(Dollars in thousands)	2004				2003			
	Carrying Value	Market Value	Repurchase Liability	Repo Rate	Carrying Value	Market Value	Repurchase Liability	Repo Rate
<b>Mortgage-Backed Securities</b>								
<b>GNMA</b>								
Term up to 30 days	\$ 1,731,830	\$ 1,702,382	\$ 1,690,472	2.37%	\$ -	\$ -	\$ -	-
Term over 90 days	774,427	793,758	776,663	1.71%	424,341	419,753	453,000	1.90%
<b>FHLMC and FNMA</b>								
Term up to 30 days	345,037	340,083	317,609	2.37%	280,748	273,543	267,538	1.14%
Term of 30 to 90 days	258,466	256,446	248,125	2.41%	-	-	-	-
Term over 90 days	151,444	148,084	117,103	1.78%	155,218	151,128	106,604	1.74%
<b>CMO Certificates</b>								
Term up to 30 days	11,912	11,831	11,551	2.45%	14,911	14,857	13,268	1.38%
Term over 90 days	-	-	-	-	9,967	9,746	6,467	2.80%
<b>Debt Securities</b>								
<b>FHLB Notes</b>								
Term up to 30 days	15,704	16,001	15,901	2.37%	-	-	-	-
Term of 30 to 90 days	90,765	91,788	89,835	3.13%	-	-	-	-
Term over 90 days	438,267	433,878	400,385	5.38%	489,785	490,090	471,541	5.49%
<b>FHLB and FHLMC</b>								
<b>Zero Coupons</b>								
Term up to 30 days	112,918	111,912	108,500	2.10%	-	-	-	-
Term of 30 to 90 days	148,724	145,771	134,694	2.67%	-	-	-	-
Term over 90 days	124,726	118,283	99,750	2.91%	289,322	286,817	271,921	4.33%
<b>FHLMC and FNMA Notes</b>								
Term up to 30 days	47,988	48,008	46,519	2.37%	-	-	-	-
Term of 30 to 90 days	50,000	49,500	45,121	2.41%	-	-	-	-
Term over 90 days	2,000	2,026	1,845	2.78%	-	-	-	-
<b>U.S. Treasury Securities</b>								
Term up to 30 days	881,600	852,531	859,241	1.60%	1,073,872	1,039,632	1,039,299	0.43%
Term of 30 to 90 days	56,129	52,089	48,621	5.90%	-	-	-	-
Term over 90 days	871,029	839,032	810,546	4.99%	609,405	575,240	478,387	4.44%
	<u>\$ 6,112,966</u>	<u>\$ 6,013,403</u>	<u>\$ 5,822,481</u>	<u>2.78%</u>	<u>\$ 3,347,569</u>	<u>\$ 3,260,806</u>	<u>\$ 3,108,025</u>	<u>2.49%</u>

**18. Advances from the Federal Home Loan Bank**

Advances from the FHLB consisted of the following:

(In thousands)	December 31,	
	2004	2003
Advances from the FHLB with maturities ranging from January 2005 to November 2012 (2003 – February 2004 to November 2012), at various fixed and adjustable rates averaging 3.98% and 3.89% at December 31, 2004 and 2003, respectively	<u>\$ 1,294,500</u>	<u>\$ 1,206,500</u>

At December 31, 2004, the Company had pledged qualified collateral in the form of first mortgage notes, investments and mortgage-backed securities with a market value of \$1.4 billion to secure the above advances from the FHLB. According to contractual agreements, such investments can be repledged by the counterparty.

**19. Loans Payable**

At December 31, 2004 and 2003, loans payable consisted of warehousing lines of credit and gestation or presale facilities with credit lines totaling approximately \$980.0 million and \$851.4 million, respectively. Advances under these facilities are secured by mortgage loans.

Outstanding loans payable consisted of the following:

(In thousands)	December 31,	
	2004	2003
Loans payable resulting from the use of warehousing lines of credit and gestation or presale facilities due in 2005, at various variable rates averaging 3.17% and 2.12% at December 31, 2004 and 2003, respectively, and other financing arrangements	<u>\$ 279,560</u>	<u>\$ 178,334</u>

Maximum borrowings outstanding at any month end during 2004 and 2003 were \$335 million and \$292 million, respectively. The approximate average monthly outstanding balance of loans payable during the periods were \$226 million and \$243 million, respectively. The weighted-average interest rate of such borrowings, computed on a monthly basis, was 2.66% in 2004 and 2.51% in 2003.

The existing warehousing credit facilities and other financing arrangements require the Company to maintain certain capital ratios and to comply with other requirements. At December 31, 2004, the Company was in compliance with these requirements.

**20. Notes Payable**

Notes payable consisted of the following:

<i>(In thousands)</i>	December 31,	
	2004	2003
\$625 million floating rate senior notes (2.91% at December 31, 2004), due on July 20, 2007, paying interest quarterly	\$ 625,330	-
\$115 million floating rate senior notes (3.07% at December 31, 2004), due on December 7, 2005, paying interest quarterly	115,000	-
8.50% medium-term notes due in July 2004, paying interest semiannually on January 8 and July 8	-	200,000
\$100 million notes, net of discount, bearing interest at 7.65%, due on March 26, 2016, paying interest monthly	98,372	98,228
7.84% senior notes due on October 10, 2006, paying interest semiannually on April 10 and October 10	75,000	75,000
\$30 million notes, net of discount, bearing interest at 7.00%, due on April 26, 2012, paying interest monthly	29,560	29,499
\$40 million notes, net of discount, bearing interest at 7.10%, due on April 26, 2017, paying interest monthly	39,339	39,285
\$30 million notes, net of discount, bearing interest at 7.15%, due on April 26, 2022, paying interest monthly	29,476	29,446
Senior term notes at fixed rates ranging from 8.45% to 8.55% (2003 – 8.35% to 8.55%) with maturities ranging from August 2005 to August 2007 (2003 – August 2004 to August 2007), paying interest semiannually on February 28 and August 31	24,000	29,000
Bonds payable secured by mortgage on building at fixed rates ranging from 6.20% to 6.90% (2003 – 6.15% to 6.90%), with maturities ranging from June 2005 to December 2029 (2003 – June 2004 to December 2029), paying interest monthly	51,065	51,735
Notes payable, collateralized by CMO certificates at variable interest rates (3.96% and 2.87% at December 31, 2004 and 2003, respectively), due on June 30, 2005, paying interest monthly	6,089	6,467
7.50% note payable, collateralized by mortgage loans, paying principal and interest monthly through January 2019	9,225	41,208
Zero coupon senior notes (effective rate of 6.50%) due on April 30, 2007	2,191	2,058
Notes payable at fixed rates, 7.00% at December 31, 2004 (2003 – ranging from 7.00% to 7.63%), with maturities ranging from February to March 2005 (2003 – August 2004 to March 2005), paying interest monthly	555	655
	\$ 1,105,202	\$ 602,581

## **21. Accrued Expenses and Other Liabilities**

Accrued expenses and other liabilities consisted of the following:

(In thousands)	December 31,	
	2004	2003
Amounts retained on mortgage loans, generally paid within 5 days	\$ 4,003	\$ 1,735
Customer mortgages and closing expenses payable	19,607	14,747
Deferred compensation plan	2,114	1,976
Incentive compensation payable	4,845	3,503
Accrued interest payable	50,926	40,899
Accrued expenses and other payables	86,947	109,716
Deferred tax liability	7,945	65,106
	<u>\$ 176,387</u>	<u>\$ 237,682</u>

## **22. Income Taxes**

The Company is exempt from the payment of Puerto Rico income taxes on the interest earned on mortgage loans on residential properties located in Puerto Rico that are insured or guaranteed pursuant to the provisions of the National Housing Act of June 27, 1934, as amended (referred to as "FHA loans"), or pursuant to the provisions of the Servicemen's Readjustment Act of 1944, as amended (referred to as "VA loans"), and that were executed after June 30, 1983, and prior to August 1, 1997. After that date, only those FHA and VA loans financing the original acquisition of newly constructed housing in Puerto Rico and securities backed by such mortgage loans qualify for tax-exempt treatment. The amendment grandfathered the tax-exempt status of FHA and VA loans originated prior to August 1, 1997, and securities backed by such mortgage loans.

Given the beneficial tax characteristics of these assets, the Company holds such loans and mortgage-backed securities for longer periods of time prior to sale in order to maximize the tax-exempt interest produced by these securities and loans. Therefore, net interest income has generally represented a greater proportion of the Company's total net income than it does in a typical mortgage banking institution.

Doral Financial also invests in U.S. Treasury and agency securities that are exempt from Puerto Rico taxation and are not subject to federal income taxation because of the portfolio interest deduction to which Doral Financial is entitled as a foreign corporation. In addition, Doral Financial uses its international banking entity subsidiary to invest in various U.S. securities, the interest income and gain on which is exempt from Puerto Rico income tax and excluded from federal income tax on the basis of the portfolio interest deduction in the case of interest, and in the case of capital gains, because the gains are sourced outside the United States. The international banking entity subsidiary is exempt from income taxes on its international (including U.S.) activities.

Those operations of the Company conducted through Puerto Rico subsidiaries are subject to Puerto Rico income tax on income derived from all sources. The Company's Puerto Rico subsidiaries are also subject to United States income taxes on certain types of investment income from U.S. sources and also on income effectively connected with any trade or business from U.S. sources. However, any federal income tax, subject to certain conditions and limitations, is creditable as a foreign tax credit against the Puerto Rico income tax liability.

Except for the operations of Doral Bank-NY and Doral Money, substantially all of the Company's operations are conducted through subsidiaries in Puerto Rico. Doral Bank-NY and Doral Money are U.S. corporations and are subject to U.S. income tax on their income derived from all sources. For the years ended December 31, 2004, 2003 and 2002, the provision for income taxes for the Company's U.S. subsidiaries amounted to approximately \$1.5 million, \$2.0 million and \$5.5 million, respectively.

Consolidated tax returns are not permitted under the Puerto Rico Internal Revenue Code; therefore, income tax returns are filed individually by each entity that conducts business as a Puerto Rico corporation.

On August 22, 2004, local legislation was enacted to provide a temporary reduction in the long-term capital gain tax rates. The law amends the Puerto Rico Internal Revenue Code of 1994 to reduce the long-term capital gain tax rates by fifty percent for transactions occurring from July 1, 2004, through June 30, 2005. The maximum long-term capital gain tax rate applicable to gains on sale of property located in Puerto Rico during this period has been reduced to 6.25% from 12.5% for corporations and partnerships. To take advantage of this reduction, during the fourth quarter of 2004, the Company completed an intercompany sale of approximately \$536.6

million in IOs to accelerate the realization of long-term capital gains that had been deferred for tax purposes. The sale resulted in the recognition of an income tax benefit of approximately \$77.0 million and a reduction in the deferred tax liability associated with the IOs. This income tax benefit represents the difference between the deferred tax liability on the IOs and the long-term capital gain tax rate of 6.25%. Excluding this transaction, the effective income tax rate for

Doral Financial and its consolidated subsidiaries would have been 17.8% for 2004.

#### **Reconciliation of Effective Tax Rate**

The provision for income taxes of the Company differs from amounts computed by applying the applicable Puerto Rico statutory rate to income before taxes. A reconciliation of the difference follows:

(Dollars in thousands)	Year ended December 31,					
	2004		2003		2002	
	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income	Amount	% of Pre-tax Income
Income before income taxes	\$ 501,723		\$ 393,365		\$ 260,976	
Tax at statutory rates	\$ 195,672	39.0	\$ 153,412	39.0	\$ 101,781	39.0
Tax effect of exempt income, net of expense disallowance	(54,565)	(10.9)	(65,092)	(16.6)	(64,192)	(24.6)
Tax effect of capital gains	(49,670)	(9.9)	(14,620)	(3.7)	(2,244)	(0.9)
Effect of reduction of capital gain tax rates	(79,669)	(15.9)	-	-	-	-
Other, net	330	0.1	(1,634)	(0.4)	4,663	1.8
Provision for income taxes	<u>\$ 12,098</u>	<u>2.4</u>	<u>\$ 72,066</u>	<u>18.3</u>	<u>\$ 40,008</u>	<u>15.3</u>

The components of income tax expense for the years ended December 31 are summarized below:

(In thousands)	2004	2003	2002
Current income tax expense	\$ 68,271	\$ 32,086	\$ 24,296
Deferred income tax (benefit) expense	(56,173)	39,980	15,712
Total income tax expense	<u>\$ 12,098</u>	<u>\$ 72,066</u>	<u>\$ 40,008</u>

At December 31, the components of the net deferred tax liability were:

(In thousands)	2004	2003	
Deferred income tax liability resulting from:			
Deferred income for tax purposes	\$ 54,645	\$ 120,332	
Deferred income tax asset resulting from:			
Unrealized losses on securities	4,543	4,545	
Unrealized losses on derivative activities	11,311	14,455	
Stock-based compensation	5,538	1,751	
Other reserves and allowances	14,529	21,882	
Net deferred origination fees	970	2,770	
Allowance for loan losses	9,809	9,823	
Net deferred tax liability	<u>\$ 7,945</u>	<u>\$ 65,106</u>	

As of December 31, 2004, the Company had Alternative Minimum Tax ("AMT") credits available to reduce future regular tax liability in excess of AMT amounting to \$13.9 million, with the associated deferred tax asset fully reserved because

the realization of such credits is not probable. Over the past several years, the Company's AMT liability has consistently exceeded its regular tax liability. The Company does not anticipate a reversal of this situation in the foreseeable future.

### **23. Related Party Transactions**

At December 31, 2004, the Company had \$3.8 million of loans outstanding to officers, directors and stockholders, of which \$3.1 million are secured by mortgages on real estate. Furthermore, the Company had construction loans receivable outstanding and commitments to extend credit to related parties of \$46.6 million and approximately \$3.1 million, respectively.

During 2004, the Company purchased a floor and parking spaces in a commercial condominium building next to the Company's headquarters for \$5.3 million from a partnership in which a related party held a 50% interest. During 2003, the Company had purchased two floors in that building for \$8.7 million.

### **24. Financial Instruments with Off-Balance Sheet Risk**

The Company enters into financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments may include commitments to extend credit and sell mortgage-backed securities and loans. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position.

The contractual amounts of these instruments reflect the extent of involvement the Company has in particular classes of financial instruments. The Company's exposure to credit losses in the event of nonperformance by the other party to the financial instrument for commitments to extend credit or for forward sales is represented by the contractual amount of these instruments. The Company uses the same credit policies in making these commitments as it does for on-balance-sheet instruments. At December 31, 2004, commitments to extend credit and commercial and financial standby letters of credit amounted to approximately \$596.8 million and \$4.5 million, respectively, and commitments to sell mortgage-backed securities and loans amounted to approximately \$4.2 billion. Management believes that the Company has the ability to meet these commitments and that no loss will result from the same. Commitments to extend credit are agreements to lend to a customer as long as the conditions established in the contract are met. Commitments generally have fixed expiration dates or other termination clauses. Generally, the Company does not enter into interest rate lock or forward sale loan commitments with borrowers or investors. Commitments are generally to sell non-conforming loans that bear variable pass-through rates that approximate fair value.

A letter of credit is an arrangement that represents an obligation on the part of the Company to a designated third party,

contingent upon the failure of the Company's customer to perform under the terms of the underlying contract with a third party. The amount in letters of credit represents the maximum amount of credit risk in the event of non-performance by these customers. Under the terms of a letter of credit, an obligation arises only when the underlying event fails to occur as intended, and the obligation is generally up to a stipulated amount and with specified terms and conditions. Letters of credit are used by the customer as a credit enhancement and typically expire without having been drawn upon.

The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the counterparty.

A geographic concentration exists within the Company's loan servicing portfolio, since approximately 98% of the Company's lending activity is with customers located in Puerto Rico, and most of its loans are secured by properties located in Puerto Rico.

Options on futures contracts confer the right from sellers to buyers to take a future position at a stated price. Risks arise from the possible inability of counterparties to meet the terms of their contracts and from movements in securities values and interest rates. The Company controls the credit risk of its futures contracts through credit approvals, limits and monitoring procedures.

Collateral for securities purchased under agreements to resell is kept by the Company under custody agreements. Collateral for securities sold under agreements to repurchase is kept by the counterparty.

**25. Commitments and Contingencies**

The Company has several non-cancelable operating leases for office facilities expiring from 2005 through 2010 and thereafter. Total minimum rental commitments for leases in effect at December 31, 2004, were as follows:

<i>(In thousands)</i>	Amount
2005	\$ 6,736
2006	6,455
2007	6,297
2008	5,941
2009	5,616
2010 and thereafter	32,376
	\$ 63,421

Total rent expense for the years ended December 31, 2004, 2003 and 2002, amounted to approximately \$7.4 million, \$6.9 million, and \$7.5 million, respectively.

The Company is subject to legal proceedings and claims that have arisen in the ordinary course of business and have not been adjudicated. Management believes that these actions, when finally concluded, will not have a material adverse effect upon the financial position, results of operations or cash flows of the Company.

**26. Retirement and Compensation Plans**

The Company maintains a profit-sharing plan with a cash or deferred arrangement named the Doral Financial Corporation Retirement Savings and Incentive Plan ("the Plan"). The Plan is available to all employees of Doral Financial who have attained age 18 and complete one year of service with the Company. Participants in the Plan have the option of making pre-tax or after-tax contributions. The Company makes a matching contribution that is invested in its common stock equal to \$0.50 for every dollar of pre-tax contribution made by participants to the Plan, up to 5% of the participant's basic compensation, as defined. The Company is also able to make fully discretionary profit-sharing contributions to the Plan. The Company's expense related to its retirement plan during the years ended December 31, 2004, 2003 and 2002, amounted to approximately \$1.0 million, \$964,000, and \$1.3 million, respectively.

The Company has unfunded deferred incentive compensation arrangements (the "Deferred Compensation") with certain

employees. The Deferred Compensation is determined as a percentage of net income arising from the mortgage-banking activities, as defined, and is payable to participants after a five-year vesting period. The expense for the years ended December 31, 2004, 2003 and 2002, amounted to approximately \$430,000, \$492,000 and \$512,000, respectively.

The Company also has incentive compensation arrangements payable currently with certain officers. The incentive payments are based on the amount of consolidated net income (adjusted for certain amounts such as extraordinary gains or losses) in excess of an established return on the stockholders' equity target, as defined in the agreements. The expense under these arrangements for the years ended December 31, 2004, 2003 and 2002, amounted to approximately \$5.1 million, \$3.8 million and \$3.9 million, respectively.

**27. Capital Stock and Additional Paid-In Capital**

On September 29, 2003, and October 8, 2003, the Company issued 1,200,000 shares and 180,000 shares, respectively, of its 4.75% Perpetual cumulative convertible preferred stock (the "convertible preferred stock") having a liquidation preference of \$250 per share in a private offering to qualified institutional buyers pursuant to Rule 144A. The convertible preferred stock ranks on parity with the Company's 7.00% noncumulative monthly income preferred stock, Series A (the "7% preferred stock"), 8.35% noncumulative monthly income preferred stock, Series B (the "8.35% preferred stock") and 7.25% noncumulative monthly income preferred stock, Series C (the "7.25% preferred stock"), with respect to dividend rights and rights upon liquidation, winding up or dissolution (see description below). The net proceeds of the Company

after the underwriting discounts and expenses were approximately \$336.5 million. Each share of convertible preferred stock is currently convertible into 6,2856 shares of common stock, subject to adjustment under specific conditions. As of December 31, 2004, there were 1,380,000 shares issued and outstanding. During 2004, the Company paid dividends of \$11.875 per share (an aggregate of \$16.4 million) on the convertible preferred stock. Refer to Note 30 for additional information regarding specific conditions for the convertible preferred stock.

During the second quarter of 2002, the Company issued 4,140,000 shares of its 7.25% preferred stock at a price of \$25 per share, its liquidation preference. As of December 31,

2004, there were 4,140,000 shares issued and outstanding. During 2004, the Company paid dividends of \$1.8125 per share (an aggregate of \$7.5 million) on the 7.25% preferred stock. The 7.25% preferred stock may be redeemed at the option of the Company beginning on May 31, 2007, at varying redemption prices starting at \$25.50 per share. The net proceeds to the Company after the underwriting discounts and expenses were approximately \$100 million.

On August 31, 2000, the Company issued 2,000,000 shares of its 8.35% preferred stock at a price of \$25 per share, its liquidation preference. As of December 31, 2004, there were 2,000,000 shares issued and outstanding. During 2004, the Company paid dividends of \$2.0875 per share (an aggregate of \$4.2 million) on the 8.35% preferred stock. The 8.35% preferred stock may be redeemed at the option of the Company beginning on September 30, 2005, at varying redemption prices that start at \$25.50 per share.

On February 22, 1999, the Company issued 1,495,000 shares of its 7% preferred stock at a price of \$50 per share, its liquidation preference. As of December 31, 2004, there were 1,495,000 shares issued and outstanding. During 2004, the Company paid dividends of \$3.50 per share (an aggregate of \$5.2 million) on the 7% preferred stock. The 7% preferred stock may be redeemed at the option of the Company beginning February 28, 2004, at varying redemption prices that start at \$51.00 per share.

The 7.25% preferred stock, 8.35% preferred stock and 7% preferred stock (collectively, the "nonconvertible preferred stocks") are not convertible into shares of common stock or any other equity securities and have equal rank as to the payment of dividends and rights on liquidation. The holders of the nonconvertible preferred stocks are entitled to receive non-cumulative cash dividends on their liquidation preference when declared by the Board of Directors at the annual rate established for each series, payable monthly. The terms of the nonconvertible preferred stocks prohibit the Company from declaring or paying any dividends on the common stock (!) unless all accrued and unpaid dividends on the nonconvertible

preferred stocks for the preceding 12 dividend periods have been paid and the full dividend on the nonconvertible preferred stocks for the current monthly dividend period is contemporaneously declared and paid or set aside for payment or (2) if the Company has defaulted in the payment of the redemption price of any shares of the nonconvertible preferred stocks called for redemption. The terms of the nonconvertible preferred stocks provide that if the Company is unable to pay in full dividends on a series of nonconvertible preferred stock, all dividends will be distributed pro rata among the outstanding series of nonconvertible preferred stock.

The ability of the Company to pay dividends in the future is limited by various restrictive covenants contained in the debt agreements of the Company, the earnings, cash position and capital needs of the Company, general business conditions and other factors deemed relevant by the Company's Board of Directors. The Company is prohibited under the Indenture of its 7.84% Senior Notes and an agreement with another financial institution from paying dividends on capital stock (other than dividends payable in the form of capital stock or stock rights) if an event of default under any such agreement exists at such time, or if the amount of dividends payable by the Company together with the aggregate amount in dividends paid and other capital distributions made since the specified dates exceed a defined amount. In addition, under the Syndicated Credit Agreement, the Senior Notes Indenture and other debt agreements of the Company, the Company is prohibited from paying dividends if it fails to maintain specified minimum levels of net worth and dividend ratios, and certain other financial ratios.

As discussed in Note 3, current regulations limit the amount in dividends that Doral Bank-PR and Doral Bank-NY may pay. Payment of such dividends is prohibited if, among other things, the effect of such payment would cause the capital of Doral Bank-PR or Doral Bank-NY to fall below the regulatory capital requirements. In addition, the Federal Reserve Board has issued a policy statement that provides that insured banks and financial holding companies should generally pay dividends only out of current operating earnings.

## **28. Stock Option Plans**

From April 16, 1997, to April 20, 2004, the Company offered an employee stock option plan (the "Old Plan"). This plan, as amended in 2001, allowed for the granting of up to 6,750,000 purchase options on shares of the Company's common stock to employees, including officers and directors who are also employees of the Company. The Compensation Committee of the Board of Directors (the "Compensation Committee") had the authority and absolute discretion to determine the number of stock options

to be granted, their vesting rights, and the option exercise price. The vesting rights, however, could not exceed ten years, and the exercise price may not be lower than the market value at the date of the grant.

The Old Plan also permitted the Compensation Committee to grant rights to optionees ("stock appreciation rights") under which an optionee may surrender any exercisable stock option in return for cash equal to the excess of the fair value

of the common stock to which the option is related at the time of exercise over the option price of the common stock at grant date. The Old Plan provided for a proportional adjustment in the exercise price and the number of shares that can be purchased in the event of a stock split, reclassifications of stock and a merger or reorganization.

Effective April 21, 2004, the Company adopted the Doral Financial Corporation Omnibus Incentive Plan (the "Omnibus Plan"). The Omnibus Plan provides for equity-based compensation incentives (the "awards") through the grant of stock options, stock appreciation rights, restricted stock, restricted stock units and dividend equivalents, as well as cash and equity-based performance awards. This plan allows the issuance of up to 4,000,000 shares of common stock subject to adjustments for stock splits, reorganization and other similar events (as described below), to any employee, including officers and directors who are also employees of the Company. The Compensation Committee has full authority and absolute discretion to determine those eligible to receive awards and to establish the terms and conditions of any awards; however, the Omnibus Plan has various limits and vesting restrictions that apply to individual and aggregate awards. In case of stock split, reorganization, merger or other similar event affecting the common stock, the Compensation Committee, in its discretion, shall adjust appropriately (a) the aggregate number of shares of common stock available for awards, (b) the aggregate limitations on the number of shares that may be awarded as a particular type of award or that may be awarded to any particular participant in any particular period, and (c) the aggregate number of shares subject to outstanding awards and the respective exercise prices or base prices applicable

to outstanding awards. During 2004, no awards were granted under the Omnibus Plan.

Since January 1, 2003, the Company expenses the fair value of stock options granted to employees using the "modified prospective" method described in SFAS No. 148. Under this method, the Company expenses the fair value of all employee stock options granted after January 1, 2003, as well as the unvested portions of previously granted options. The compensation expense associated with expensing stock options for 2004 was approximately \$9.7 million (2003 - \$4.5 million). During 2002, the Company used the intrinsic value method to account for its stock option plan. Under the intrinsic value-based method, compensation expense is recognized for the excess, if any, of the quoted market price of the stock on the grant date over the amount an employee must pay to acquire the stock. During 2002, the Company granted stock options under the Old Plan to buy shares of the Company's stock that will be exercisable over a period ranging from one to ten years. The options granted do not contain stock appreciation rights. Fifty percent (50%) of the options granted vest on the first anniversary of the grant date and the remaining 50% vest on the second anniversary. The option prices equaled the quoted market price of the stock at the grant date; therefore, no compensation cost was recognized. At December 31, 2004, there were 4,740,038 stock options exercisable under the Old Plan. The remaining stock will become exercisable in 2005 (780,000) and 2006 (7,500).

The activity of stock options, adjusted by the stock split discussed in Note 2, during 2004, 2003 and 2002 is set forth below:

	2004		2003		2002	
	Number of Options	Weighted- Average Exercise Price	Number of Options	Weighted- Average Exercise Price	Number of Options	Weighted- Average Exercise Price
Beginning of year	3,972,488	\$ 9.97	4,103,775	\$ 9.83	2,533,725	\$ 5.13
Options granted	1,560,000	31.60	--	--	1,773,000	16.07
Options exercised	(4,950)	6.76	(31,287)	5.66	(202,950)	5.66
End of year	5,527,538	\$ 16.08	3,972,488	\$ 9.97	4,103,775	\$ 9.83

The following table summarizes the exercise price and the weighted-average remaining contractual life of the options outstanding at December 31, 2004.

Exercise Price	Outstanding Options	Weighted-Average Contract Life (years)
<u>\$ 6.76</u>	<u>43,538</u>	<u>3.25</u>
<u>\$ 5.00</u>	<u>2,092,500</u>	<u>4.98</u>
<u>\$ 5.28</u>	<u>58,500</u>	<u>5.29</u>
<u>\$ 16.08</u>	<u>1,766,250</u>	<u>7.18</u>
<u>\$ 15.57</u>	<u>6,750</u>	<u>7.30</u>
<u>\$ 31.51</u>	<u>1,470,000</u>	<u>9.00</u>
<u>\$ 33.73</u>	<u>15,000</u>	<u>9.06</u>
<u>\$ 32.96</u>	<u>75,000</u>	<u>9.00</u>

The fair value of the options granted in 2004 and 2002 was estimated using the Black-Scholes option-pricing model with the following assumptions:

	2004	2002
Stock price and exercise price	\$ 31.60	\$ 16.07
Stock option estimated fair value	\$ 12.45	\$ 5.09
Expected stock option term (years)	9	4
Expected volatility	31%	38%
Expected dividend yield	1.51%	1.52%
Risk-free interest rate	4.39%	4.16%

#### **29. Supplemental Income Statement Information**

Employee costs and other expenses are shown in the Consolidated Statements of Income, net of direct loan origination costs which, pursuant to SFAS No. 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases," are capitalized as part of the carrying cost of mortgage loans and are offset against net gains on mortgage loan sales and fees when the loans are sold or amortized as yield adjustment in the case of loans held for investments (loans receivable).

Set forth below is a reconciliation of the application of SFAS No. 91 to employee costs and other expenses:

(In thousands)	Year ended December 31,		
	2004	2003	2002
Employee costs, gross	\$ 132,309	\$ 108,503	\$ 87,380
Deferred costs pursuant to SFAS No. 91	<u>43,004</u>	<u>25,563</u>	<u>30,737</u>
Employee cost, net	<u>\$ 89,305</u>	<u>\$ 82,940</u>	<u>\$ 56,643</u>
Other expenses, gross	\$ 29,960	\$ 24,765	\$ 22,286
Deferred costs pursuant to SFAS No. 91	<u>5,942</u>	<u>4,518</u>	<u>8,248</u>
Other expenses, net	<u>\$ 24,018</u>	<u>\$ 20,247</u>	<u>\$ 14,038</u>

As of December 31, 2004, the Company had a net deferred origination fee on mortgage loans held for sale and loans receivable amounting to \$2.2 million (2003 – net deferred origination cost of \$1.4 million) and \$11.0 million (2003 – \$18.0 million), respectively.

### **30. Earnings per Share**

The reconciliation of the numerator and denominator of the basic and diluted earnings per share, adjusted to reflect the adoption of EITF Issue 04-8, follows:

(Dollars in thousands, except per share data)	Year ended December 31,		
	2004	2003	2002
<b>Net Income:</b>			
Net Income	\$ 489,625	\$ 321,299	\$ 220,968
Convertible preferred stock dividends	(16,387)	(4,176)	–
Nonconvertible preferred stock dividends	<u>(16,912)</u>	<u>(16,912)</u>	<u>(13,730)</u>
Net income attributable to common stock	<u>456,326</u>	<u>300,211</u>	<u>207,238</u>
Convertible preferred stock dividends	<u>16,387</u>	<u>4,176</u>	<u>–</u>
Net income attributable to common stock plus assumed conversions	<u>\$ 472,713</u>	<u>\$ 304,387</u>	<u>\$ 207,238</u>
<b>Weighted-Average Shares:</b>			
Basic weighted-average number of common shares outstanding	107,907,699	107,861,415	107,697,114
Convertible preferred stock	8,674,128	2,227,686	–
Incremental shares issuable upon exercise of stock options	<u>3,162,349</u>	<u>2,572,747</u>	<u>1,741,581</u>
Diluted weighted-average number of common shares outstanding	<u>119,744,176</u>	<u>112,661,848</u>	<u>109,438,695</u>
<b>Net Income per Common Share:</b>			
Basic	<u>\$ 4.23</u>	<u>\$ 2.78</u>	<u>\$ 1.92</u>
Diluted	<u>\$ 3.95</u>	<u>\$ 2.70</u>	<u>\$ 1.89</u>

For the years ended December 31, 2004 and 2003, there were 1,380,000 shares of the Company's 4.75% Perpetual cumulative convertible preferred stock issued in the second half of 2003 and included in the computation of diluted earnings per share, based on the provisions of EITF Issue 04-8, although the conditions for conversion as described below had not been met. Each share of convertible preferred stock is currently convertible into 6.2856 shares

of common stock, subject to adjustment under specific conditions. The option of the purchasers to convert the convertible preferred stock into shares of the Company's common stock is exercisable only (a) if during any fiscal quarter after September 30, 2003, the closing sale price of the Company's common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading date of the preceding fiscal quarter exceeds

120% of the conversion price of the convertible preferred stock (currently 120% of \$39.77, or \$47.72); (b) upon the occurrence of certain corporate transactions; or (c) upon the delisting of the Company's common stock. On or after September 30, 2008, the Company may, at its option, cause the convertible preferred stock to be converted into the number of shares of common stock that are issuable at the conversion price. The Company may only exercise its conversion right if the closing sale price of the Company's

common stock exceeds 130% of the conversion price of the convertible preferred stock in effect for 20 trading days within any period of 30 consecutive trading days ending on a trading day not more than two trading days prior to the date the Company gives notice of conversion.

For the years ended December 31, 2004, 2003 and 2002, all stock options outstanding were included in the computation of weighted-average outstanding shares.

### **31. Disclosures about Fair Value of Financial Instruments**

The table below presents the carrying amounts and fair values of the Company's financial instruments at December 31, 2004 and 2003. The fair value of financial instruments is the amount at which the instruments could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Significant differences can arise between the fair value and carrying amount of financial instruments that are recognized at historical costs.

<i>(In thousands)</i>	2004		2003	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets:</b>				
Cash and due from banks	\$ 64,940	\$ 64,940	\$ 84,713	\$ 84,713
Money market investments	2,470,786	2,470,786	870,009	870,009
Securities held for trading	1,243,543	1,243,543	944,150	944,150
Securities available for sale	4,982,508	4,982,508	2,850,598	2,850,598
Securities held to maturity	2,316,780	2,253,693	1,640,909	1,584,102
Mortgage loans held for sale	1,560,949	1,580,057	1,966,608	2,019,595
Loans receivable	1,752,490	1,749,696	1,410,849	1,436,521
Servicing assets	203,245	220,097	167,498	182,076
<b>Financial liabilities:</b>				
Deposits	\$ 3,643,080	\$ 3,643,895	\$ 2,971,272	\$ 2,974,748
Securities sold under agreements to repurchase	6,305,163	6,312,851	3,602,942	3,615,056
Advances from FHLB	1,294,500	1,295,923	1,206,500	1,211,904
Loans payable	279,560	279,560	178,334	178,334
Notes payable	1,105,202	1,144,100	602,581	628,591

The following notes summarize the major methods and assumptions used in estimating the fair values of financial instruments:

*Cash and due from banks, money market investments and loans payable:* valued at the carrying amounts in the Consolidated Statements of Financial Condition. The carrying amounts are reasonable estimates of fair value due to the relatively short period to maturity.

*Mortgage loans held for sale, securities held for trading, securities held to maturity and securities available for sale:* valued at quoted market prices, if available. For securities without quoted prices, fair values represent quoted market prices for comparable instruments. In certain other cases, particularly in

the case of the Company's IOs, fair values have been estimated based on assumptions concerning the amount and timing of estimated future cash flows and assumed discount rates reflecting appropriate degrees of risk. The fair value of derivative financial instruments is estimated as the amounts that the Company would receive or pay to terminate the contracts at the reporting date, taking into account the current unrealized gains or losses of open contracts. Market or dealer quotes are available for many derivatives; otherwise, pricing or valuation models are applied to current market information to estimate fair value.

*Loans receivable:* valued on the basis of estimated future principal and interest cash flows, discounted at rates commensurate with the loan characteristics. Loan prepayments are assumed

to occur at speeds experienced in previous periods when interest rates were at levels similar to current levels, adjusted for any differences in the interest rate scenario. Future cash flows for homogeneous categories of loans, such as residential mortgage loans, are estimated on a portfolio basis and discounted at current rates offered for similar loan terms to new borrowers with similar credit profiles. In certain circumstances, quoted market prices for securities backed by similar loans, adjusted for different loan characteristics, are also used in estimating fair value.

**Servicing assets:** valued based on the market prices for comparable servicing sales contracts based on similar types of groups of loans. To further evaluate the estimated fair value of such servicing rights, the Company utilizes independent valuations based on present value calculations of the expected future cash flows associated with the servicing rights. Such valuations are based on assumptions that market participants

would use in estimating future servicing income and expense, such as: discount rates, prepayment speeds, estimates of servicing cost, ancillary income per loan and default rates.

**Deposits:** for demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the reporting date. The fair values of fixed-maturity deposits, including certificates of deposit, are estimated using rates currently offered for deposits of similar remaining maturities. The value of long-term relationships with depositors is not taken into account in estimating the fair values disclosed.

**Notes payable, advances from FHLB and securities sold under agreements to repurchase:** valued utilizing discounted cash flow analysis over the remaining term of the obligation using market rates for similar instruments.

### **32. Risk Management Activities**

The Company's principal objective in holding derivatives and certain other financial instruments is the management of the impact of interest rate risk arising out of its portfolio holdings and related borrowings. Risk management activities are aimed at optimizing realization on sales of mortgage loans and mortgage-backed securities and net interest income, given levels of interest rate risk consistent with the Company's business strategies and within guidelines set forth by the Company's Board of Directors.

Asset-liability risk management activities are conducted in the context of the Company's sensitivity to interest rate changes. This sensitivity arises due to changes in interest rates, since many of the Company's assets are of a fixed rate nature.

Changes in interest rates affect the value of mortgage loans held for sale and securities held for trading from the time such assets are originated to the time these assets are sold on a contractual basis. Interest-bearing liabilities reprice more frequently than interest-earning assets and, therefore, the Company's net interest income is affected by changes in interest rates and the relation between long-term and short-term interest rates.

To achieve its risk management objectives, the Company uses a combination of derivative financial instruments, particularly futures and options, as well as other types of contracts such as forward sales commitments, interest rate swaps and interest rate caps and collars.

The following tables summarize the activity in derivative transactions, for the year:

(In thousands)	Notional Amount, net <sup>(1)</sup>		Fair Value, net <sup>(2)</sup>		Net gains (losses)
	At December 31, Long	Short	At December 31, Long	Short	
<b>2004</b>					
Options on futures	\$ 2,400,000	\$ -	\$ 6,992	\$ -	\$ (43,070)
Options on Eurodollars	5,500,000	400,000	(6,293)	(3,147)	4,457
Forward contracts	-	414,000	-	(713)	(713)
Options on bonds and mortgage-backed securities	1,560,000	-	1,734	-	(19,508)
Futures on U.S. Treasury bonds and notes	-	320,000	-	(1,550)	(59,107)
Futures on Eurodollars	-	7,120,000	-	(2,529)	(3,624)
	<b>\$ 9,460,000</b>	<b>\$ 8,254,000</b>	<b>\$ 2,433</b>	<b>\$ (7,939)</b>	<b>\$ (121,565)</b>
<b>2003</b>					
Options on futures	\$ 1,587,500	\$ -	\$ 12,927	\$ -	\$ 50,912
Options on Eurodollars	1,000,000	500,000	92	(1,060)	(12,926)
Forward contracts	-	40,000	-	(31)	258
Options on bonds and mortgage-backed securities	130,000	-	1,277	-	(12,649)
Futures on U.S. Treasury bonds and notes	582,200	384,500	(6,113)	(5,592)	(134,624)
Futures on Eurodollars	-	120,000	-	(377)	4,704
	<b>\$ 3,299,700</b>	<b>\$ 1,044,500</b>	<b>\$ 8,183</b>	<b>\$ (7,060)</b>	<b>\$ (104,325)</b>

- (1) Notional amount indicates the balances on which payments are being determined and does not represent the Company's exposure to counterparties' credit risk.
- (2) Fair values presented above are classified by instrument type netted by counterparty. Thus, fair values are not netted by counterparty across instrument type as required to measure counterparty credit risk exposure. The amount of derivatives assets, at fair value netted by counterparty, included in "Trading Securities" amounted to \$14.4 million and \$13.3 million, as of December 31, 2004 and 2003, respectively, and derivatives liabilities, at fair value netted by counterparty, presented as part of "Accrued expenses and other liabilities" amounted to approximately \$8.0 million and \$7.7 million as of December 31, 2004 and 2003, respectively. Refer to Note 6 for additional information regarding the impact of the fair value hedge on the consolidated results for 2004.

Other derivatives held by the Company follow:

(In thousands)	At December 31,		
	Notional Amount	Fair Value	Net gains (losses)
<b>2004</b>			
Interest rate swaps	\$ 700,000	\$ 1,819	\$ 763
Interest rate caps and collars	2,100,000	10,109	(4,239)
	<b>\$ 2,800,000</b>	<b>\$ 11,928</b>	<b>\$ (3,476)</b>
<b>2003</b>			
Interest rate swaps	\$ 200,000	\$ (3,928)	\$ (31)
Interest rate caps and collars	1,900,000	8,378	(3,025)
	<b>\$ 2,100,000</b>	<b>\$ 4,450</b>	<b>\$ (3,056)</b>

Options are contracts that grant the purchaser the right to buy or sell the underlying asset by a certain date at a specified price. The risk involved with purchased option contracts is normally limited to the price of the options. Interest rate futures contracts are commitments to either purchase or sell

designated instruments, such as U.S. Treasury securities, at a future date for a specified price. Futures contracts are generally traded on an exchange, are marked-to-market daily, and are subject to margin requirements. Forward contracts are generally over-the-counter or privately negotiated contracts

to sell a specified amount in certain instruments such as mortgage-backed securities at a specified price at a specified future date. Because these contracts are not traded on an exchange and are generally not marked-to-market on a daily basis, they are subject to greater credit risks than futures contracts.

The risk that counterparties to both derivative and cash instruments might default on their obligations is monitored on an ongoing basis. To manage the level of credit risk, the Company deals with counterparties of good credit standing, enters into master netting agreements whenever possible and, when appropriate, obtains collateral. Master netting agreements incorporate rights of set-off that provide for the net settlement of subject contracts with the same counterparty in the event of default.

All derivative financial instruments are subject to market risk, the risk that future changes in market conditions may make an instrument less valuable or more onerous. For example, fluctuations in market prices and interest rates change the market value of the instruments. Exposure to market risk is managed in accordance with risk limits set by the Board of Directors by buying or selling instruments or entering into offsetting positions.

Doral Bank-PR enters into interest rate swap agreements in managing its interest rate exposure. Interest rate swap agreements generally involve the exchange of fixed and float-

ing rate interest payment obligations without the exchange of the underlying principal. Non-performance by the counterparty will expose Doral Bank-PR to interest rate risk. At December 31, 2004, Doral Bank-PR had two interest rate swap agreements outstanding (each with a notional amount of \$100 million). They are intended to protect Doral Bank-PR from the repricing of its short-term liabilities during a rising interest rate environment. These agreements end on September 11, 2007, and September 12, 2007, respectively. The interest rate to be received on these swap agreements is 100% of the three-month LIBOR rate (2.47%, each one, at December 31, 2004) and the fixed interest rate to be paid is 3.6875% and 3.655%, respectively.

At December 31, 2004, Doral Financial, at the parent company level, had an additional three interest rate swap agreements outstanding (with an aggregate notional amount of \$500 million), ending in November 2009. The interest rate to be received on these swap agreements is 100% of the three-month LIBOR and the average fixed interest rate to be paid is 3.894%. Interest rate swap agreements are recorded at fair value with changes in the fair value reflected in net gain (loss) on securities held for trading of the Consolidated Statements of Income.

Doral Financial purchased various interest rate caps and collars, intended to protect the Company against rising interest rates. The following table summarizes interest rate caps and collars outstanding at December 31, 2004.

(Dollars In thousands)

Notional Amount	Maturity Date	Entitled Payments Conditions	Premium Paid	Fair Value
\$ 200,000	June, 2006	Excess 3-month LIBOR and 5.0%	\$ 4,865	\$ 39
\$ 400,000	March, 2007	Excess 3-month LIBOR and 5.5% provided that 3-month LIBOR is less than 8.5%	\$ 5,760	\$ 396
\$ 600,000	September, 2007	Excess 3-month LIBOR and 5.5% provided that 3-month LIBOR is less than 8.5%	\$ 5,570	\$ 1,062
\$ 100,000	February, 2008	Excess 3-month LIBOR and 5.5% provided that 3-month LIBOR is less than 8.0%	\$ 955	\$ 346
\$ 100,000	April, 2008	Excess 3-month LIBOR and 5.0% provided that 3-month LIBOR is less than 8.0%	\$ 1,000	\$ 373
\$ 200,000	April, 2008	Excess 3-month LIBOR and 8.0% provided that 3-month LIBOR is less than 10.0%	\$ 353	\$ 56
\$ 300,000	July, 2008	Excess 3-month LIBOR and 5.0% provided that 3-month LIBOR is less than 8.0%	\$ 2,715	\$ 1,457
\$ 200,000	December, 2009	Excess 3-month LIBOR and 3.95%	\$ 5,970	\$ 6,380

These instruments are recorded at fair value with changes in the fair value reflected in net gain (loss) on securities held for trading of the Consolidated Statements of Income.

### **33. Segment Information**

The Company operates in four reportable segments identified by line of business: mortgage banking, banking (including thrift operations), institutional securities operations and insurance agency activities. Management made this determination based on operating decisions particular to each business line and because each one targets different customers and requires different strategies. The majority of the Company's operations are conducted in Puerto Rico. The Company also operates in the mainland United States, principally in the New York City metropolitan area. Investment activities by Doral Bank-PR and by Doral Financial at the parent company level through their respective international banking entities are included within the banking and mortgage banking segments, respectively. During 2004, the Company phased out the operation of its international banking entity organized as a division at the parent company level.

The Company monitors the performance of its reportable segments based on pre-established goals for different financial parameters such as net income, interest rate spread, loan production and increase in market share.

The accounting policies followed by the segments are the same as those described in the Summary of Significant Accounting Policies (see Note 2).

The following tables present net interest income, non-interest income, net income and identifiable assets for each of the Company's reportable segments for the periods presented as well as for the Company's Puerto Rico and mainland U.S. operations for the periods presented.

<i>(In thousands)</i>	2004	2003	2002
<b>Net interest income</b>			
Reportable segments:			
Mortgage banking	\$ 70,227	\$ 50,040	\$ 57,935
Banking	177,417	118,015	87,301
Institutional securities	3,439	3,601	2,616
Insurance agency	5,269	2,037	1,133
Intersegment eliminations <sup>(I)</sup>	<u>9,546</u>	<u>7,787</u>	<u>3,437</u>
Consolidated net interest income	<u>\$ 265,898</u>	<u>\$ 181,480</u>	<u>\$ 152,422</u>
<b>Non-interest income</b>			
Reportable segments:			
Mortgage banking	\$ 309,240	\$ 306,968	\$ 165,868
Banking	133,036	103,523	83,331
Institutional securities	4,394	7,784	8,780
Insurance agency	10,603	7,931	7,373
Intersegment eliminations <sup>(I)</sup>	<u>(6,889)</u>	<u>(14,434)</u>	<u>(9,959)</u>
Consolidated non-interest income	<u>\$ 450,384</u>	<u>\$ 411,772</u>	<u>\$ 255,393</u>
<b>Net income</b>			
Reportable segments:			
Mortgage banking	\$ 290,269	\$ 192,515	\$ 124,884
Banking	184,661	121,369	92,388
Institutional securities	4,366	5,551	4,397
Insurance agency	10,932	6,058	4,871
Intersegment eliminations <sup>(I)</sup>	<u>(603)</u>	<u>(4,194)</u>	<u>(5,572)</u>
Consolidated net income	<u>\$ 489,625</u>	<u>\$ 321,299</u>	<u>\$ 220,968</u>
<b>Identifiable assets</b>			
Reportable segments:			
Mortgage banking	\$ 3,555,409	\$ 3,336,222	\$ 2,886,835
Banking	11,741,350	7,186,605	5,468,632
Institutional securities	155,612	160,717	480,212
Insurance agency	93,460	48,611	33,382
Intersegment eliminations <sup>(I)</sup>	<u>(443,430)</u>	<u>(338,159)</u>	<u>(447,372)</u>
Consolidated total identifiable assets	<u>\$ 15,102,401</u>	<u>\$ 10,393,996</u>	<u>\$ 8,421,689</u>

(I) For purposes of the intersegment eliminations in the above table, income includes direct intersegment loan origination costs amortized as yield adjustment and other income derived from intercompany transactions, related principally to fees and commissions paid to the Company's institutional securities subsidiary and rental income paid to Doral Properties, the Company's subsidiary that owns the Corporate headquarters facilities. Assets include internal funding and investments in subsidiaries accounted for at cost.

The breakdown of non-interest income for the mortgage banking and banking segments, for the periods presented, follows:

(In thousands)	2004	2003	2002
<b>Mortgage Banking</b>			
Non-interest income:			
Net gain on mortgage loan sales and fees	\$ 476,302	\$ 348,983	\$ 197,408
Investment activities	(183,339)	(34,336)	(29,719)
Servicing income (loss)	8,879	(10,082)	(3,359)
Commissions, fees and other income	7,398	2,403	1,538
Total mortgage banking non-interest income	<u>\$ 309,240</u>	<u>\$ 306,968</u>	<u>\$ 165,868</u>
<b>Banking</b>			
Non-interest income:			
Net gain on mortgage loan sales and fees	\$ 124,936	\$ 48,350	\$ 28,575
Investment activities	(10,506)	41,776	43,177
Servicing income (loss)	214	(1,399)	(572)
Commissions, fees and other income	18,392	14,796	12,151
Total banking non-interest income	<u>\$ 133,036</u>	<u>\$ 103,523</u>	<u>\$ 83,331</u>

The following table summarizes the financial results for the Company's Puerto Rico and mainland U.S. operations.

(In thousands)	2004	2003	2002
<b>Net interest income</b>			
Reportable operations:			
Puerto Rico	\$ 251,950	\$ 170,845	\$ 138,219
Mainland U.S.	13,814	10,575	14,988
Interoperation eliminations	134	60	(785)
Consolidated net interest income	<u>\$ 265,898</u>	<u>\$ 181,480</u>	<u>\$ 152,422</u>
<b>Non-interest income</b>			
Reportable operations:			
Puerto Rico	\$ 448,966	\$ 407,774	\$ 251,899
Mainland U.S.	1,644	4,388	6,289
Interoperation eliminations	(226)	(390)	(2,795)
Consolidated non-interest income	<u>\$ 450,384</u>	<u>\$ 411,772</u>	<u>\$ 255,393</u>
<b>Net income</b>			
Reportable operations:			
Puerto Rico	\$ 487,263	\$ 319,782	\$ 217,447
Mainland U.S.	2,193	1,628	7,101
Interoperation eliminations	169	(111)	(3,580)
Consolidated net income	<u>\$ 489,625</u>	<u>\$ 321,299</u>	<u>\$ 220,968</u>
<b>Identifiable assets</b>			
Reportable operations:			
Puerto Rico	\$ 14,587,008	\$ 9,962,713	\$ 8,022,479
Mainland U.S.	569,592	525,821	539,230
Interoperation eliminations	(54,199)	(94,538)	(140,020)
Consolidated total identifiable assets	<u>\$ 15,102,401</u>	<u>\$ 10,393,996</u>	<u>\$ 8,421,689</u>

**34. Quarterly Results of Operations (Unaudited)**

Financial data showing results for each of the quarters in 2004, 2003 and 2002 are presented below. These results are unaudited. In the opinion of management all adjustments necessary for a fair presentation have been included:

<i>(In thousands, except per share data)</i>	<b>1st</b>	<b>2nd</b>	<b>3rd</b>	<b>4th</b>
<b>2004</b>				
Interest income	\$ 126,099	\$ 137,937	\$ 146,399	\$ 160,412
Net interest income	59,053	66,646	69,854	70,345
Provision for loan losses	1,561	2,612	325	1,009
Non-interest income	114,762	126,580	130,907	135,135
Net income	103,577	114,906	120,628	150,514
Earnings per common share - Basic	0.88	0.99	1.04	1.32
Earnings per common share - Diluted	0.83	0.93	0.97	1.22
<b>2003</b>				
Interest income	\$ 109,610	\$ 109,204	\$ 109,752	\$ 124,004
Net interest income	41,277	39,906	42,933	57,364
Provision for loan losses	4,778	3,618	2,913	2,776
Non-interest income	91,419	99,204	110,897	110,252
Net income	69,987	74,977	81,681	94,654
Earnings per common share - Basic	0.61	0.66	0.72	0.80
Earnings per common share - Diluted	0.60	0.64	0.70	0.76
<b>2002</b>				
Interest income	\$ 97,083	\$ 105,330	\$ 105,369	\$ 107,818
Net interest income	35,886	37,677	39,246	39,613
Provision for loan losses	748	989	2,055	3,637
Non-interest income	49,609	57,759	67,992	80,033
Net income	46,540	51,987	58,284	64,157
Earnings per common share - Basic	0.41	0.46	0.50	0.56
Earnings per common share - Diluted	0.40	0.45	0.49	0.55

# Corporate Directory

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## Stock Listing

Common: NYSE  
(New York Stock Exchange)  
Stock Symbol: DRL

Preferred: NASDAQ  
(National Association of  
Securities Dealers)

7.00% Preferred: NASDAQ  
National Market System  
Stock Symbol: DORLP

8.35% Preferred: NASDAQ  
National Market System  
Stock Symbol: DORLO

7.25% Preferred: NASDAQ  
National Market System  
Stock Symbol: DORLN

